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Amendment to Statement on standards for accounting and review services no. 1, Compilation and review of financial statements; Statement on standards for accounting and review services 8

American Institute of Certified Public Accountants. Accounting and Review Services Committee

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American Institute of Certified Public Accountants. Accounting and Review Services Committee, "Amendment to Statement on standards for accounting and review services no. 1, Compilation and review of financial statements; Statement on standards for accounting and review services 8" (2000). *AICPA Professional Standards*. 310.

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Statement on Standards for Accounting and Review Services

Issued by the Accounting and Review Services Committee

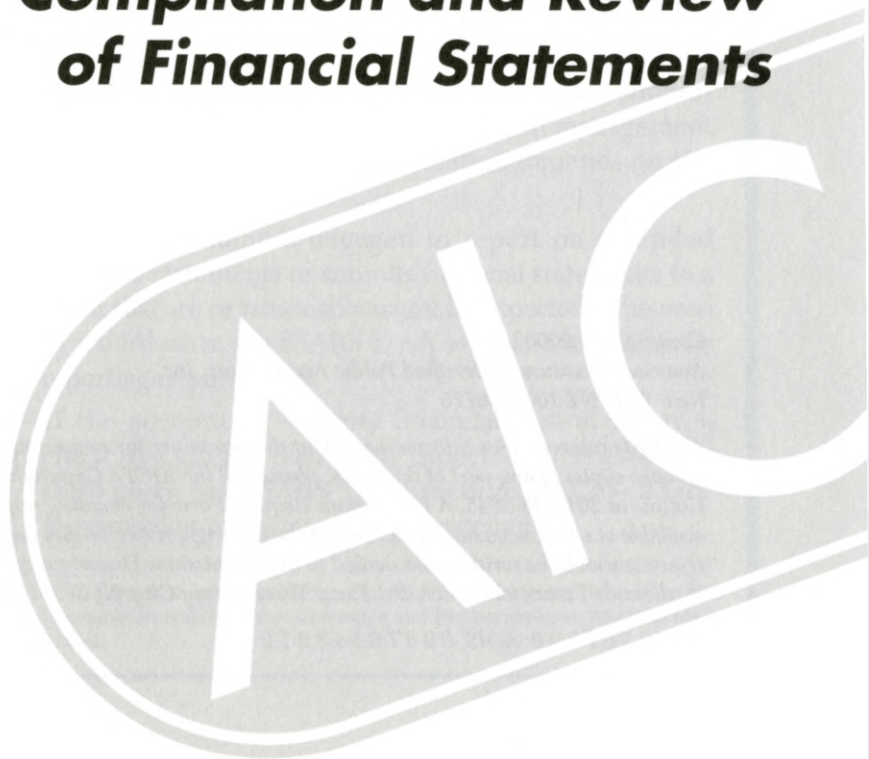
October 2000

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AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Amendment to Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements*



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Amendment to Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements*

1. This amendment provides communication and performance requirements for unaudited financial statements submitted to a client that are not expected to be used by a third party. The performance and communication requirements for such engagements would be subject to the Statement on Standards for Accounting and Review Services (SSARS) 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100), as amended. This Statement does not preclude an accountant from reporting in compliance with SSARS 1 in such engagements.

.01 This Statement sets forth the performance and communication requirements when an accountant submits unaudited financial statements of a nonpublic entity to his or her client or third parties. The accountant should not submit unaudited financial statements of a nonpublic entity to his or her client or a third party unless, as a minimum, he or she complies with the provisions of this Statement applicable to a compilation engagement.

a. *Compilation of financial statements.*¹ If the accountant performs a compilation, a communication to management is required. The type of communication depends on the following.

1. If the accountant is engaged to report on compiled financial statements or submits financial statements to a client that are or reasonably might be expected to be used by a third party, see SSARS 1, AR sections 100.11–.19 for reporting requirements.
2. If the accountant submits financial statements to a client that are not reasonably expected to be used by a third party, see SSARS 1, AR sections 100.20–.23 for required communications to management.

1. See appendix A, “Compilation of Financial Statements,” for a flowchart describing the requirements of Statements on Standards for Accounting and Review Services (SSARSs) for a compilation engagement.

In deciding whether the financial statements are or reasonably might be expected to be used by a third party, the accountant may rely on management's representation without further inquiry, unless information comes to his or her attention that contradicts management's representation.

In each of the above circumstances, the performance requirements in AR sections 100.05 and 100.07–.10 apply.

*b. Review of financial statements.*² If the accountant performs a review, see AR sections 100.05 and 100.24–.39 for performance and reporting requirements.

.02 If the accountant performs more than one service (for example, a compilation and an audit), the accountant should issue the report that is appropriate for the highest level of service rendered.³

.03 An accountant should not consent to the use of his or her name in a document or written communication containing unaudited financial statements of a nonpublic entity unless (a) the accountant has compiled or reviewed the financial statements and a report accompanies them or (b) the financial statements are accompanied by an indication that the accountant has not compiled or reviewed the financial statements and that the accountant assumes no responsibility for them. If an accountant becomes aware that his or her name has been used improperly in any client-prepared document containing unaudited financial statements, the accountant should advise the client that the use of his or her name is inappropriate and should consider what other actions might be appropriate, including consultation with his or her attorney.

2. Statements on Auditing Standards (SASs) provide guidance to the accountant who performs services in connection with the unaudited financial statements of a public entity. However, if a public entity does not have its annual financial statements audited, an accountant may review the entity's annual or interim financial statements in accordance with SSARs as permitted by footnote 4 of SAS No. 26, *Association With Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 504.05).

3. SSARS 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*, vol. 2, AR sec. 300), permits an accountant who has reviewed the financial statements of a nonpublic entity to issue a compilation report on financial statements for the same period that are included in a prescribed form that calls for departure from generally accepted accounting principles (GAAP).

Definitions

.04 Certain terms are defined for purposes of this Statement as follows.

Submission of financial statements. Presenting to a client or third parties financial statements that the accountant has prepared either manually or through the use of computer software.

Third party. All parties except for members of management who are knowledgeable about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.⁴

Nonpublic entity. Any entity other than (a) one whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally; (b) one that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market; or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b). (See SSARS 2, *Reporting on Comparative Financial Statements* [AICPA, *Professional Standards*, vol. 2, AR sec. 200].)

Financial statement. A presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with generally accepted accounting principles (GAAP)⁵ or a comprehensive basis of accounting other than GAAP.⁶ Financial

4. The accountant may wish to specify those members of management. See appendix D, "Compilation of Financial Statements Not Intended for Third-Party Use—Illustrative Engagement Letter."

5. The definition of GAAP and the hierarchy of established accounting principles presented in SAS No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1, AU sec. 411), is also applicable to compilations and reviews of financial statements performed under SSARSs.

6. The term *comprehensive basis of accounting other than generally accepted accounting principles* is defined in SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 623.04). Hereafter, reference to GAAP in this Statement includes, where applicable, an other comprehensive basis of accounting (OCBOA). SAS No. 62, AU section 623.09 and .10, provides guidance on evaluating the adequacy of disclosure in financial statements prepared in conformity with OCBOA.

forecasts, projections and similar presentations,⁷ and financial presentations included in tax returns are not financial statements for purposes of this Statement. The following financial presentations are examples of financial statements:⁸

- Balance sheet
- Statement of income
- Statement of comprehensive income
- Statement of retained earnings
- Statement of cash flows
- Statement of changes in owners' equity
- Statement of assets and liabilities (with or without owners' equity accounts)
- Statement of revenue and expenses
- Statement of financial position
- Statement of activities
- Summary of operations
- Statement of operations by product lines
- Statement of cash receipts and disbursements

A financial statement may be, for example, that of a corporation, a consolidated group of corporations, a combined group of affiliated entities, a not-for-profit organization, a governmental entity, an estate or trust, a partnership, a proprietorship, a segment of any of these, or an individual. The method of preparation (for example, manual or computer preparation) is not relevant to the definition of a financial statement.

Compilation of financial statements. Presenting in the form of financial statements⁹ information that is the representation of management (owners) without undertaking to express any assur-

7. Statement on Standards for Attestation Engagements No. 1, *Financial Forecasts and Projections* (AICPA, *Professional Standards*, vol. 1, AT sec. 200), as well as the AICPA *Guide for Prospective Financial Information*, provide guidance on preparing and reporting on financial forecasts, projections, and similar presentations.

8. SAS No. 62, AU section 623.07, provides guidance with respect to suitable titles for financial statements that are prepared in conformity with OCBOA other than GAAP.

9. AR sections 100.16-18 of this Statement provide guidance to the accountant engaged to compile financial statements that omit substantially all the disclosures required by GAAP or OCBOA.

ance on the statements. (The accountant might consider it necessary to perform other accounting services to compile the financial statements. See AR section 100.08.)

Review of financial statements. Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements for them to be in conformity with GAAP or, if applicable, with an other comprehensive basis of accounting (OCBOA). (The accountant might consider it necessary to compile the financial statements or to perform other accounting services to enable him or her to perform a review. See AR section 100.30.)

The objective of a review differs significantly from the objective of a compilation. The inquiry and analytical procedures performed in a review should provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements. No expression of assurance is contemplated in a compilation.

The objective of a review also differs significantly from the objective of an audit of financial statements in accordance with generally accepted auditing standards (GAAS). The objective of an audit is to provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole. A review does not provide a basis for the expression of such an opinion because a review does not contemplate obtaining an understanding of internal control or assessing control risk; tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter through inspection, observation, or confirmation; and certain other procedures ordinarily performed during an audit. A review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit.

Understanding With the Entity

.05 The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. However, if the engagement is to compile financial statements not expected to be used by a third party, a written communication is

required. (See AR sections 100.20-.21.) The understanding should include a description of the nature and limitations of the services to be performed and a description of the report, if a report is to be issued. The understanding should also provide (a) that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts and (b) that the accountant will inform the appropriate level of management¹⁰ of any material errors that come to his or her attention and any fraud or illegal acts that come to his or her attention, unless they are clearly inconsequential. Examples of engagement letters are presented in appendixes C, D, and E.

Compilation of Financial Statements

.06 AR sections 100.07-.10 are applicable to a compilation of financial statements, whenever the accountant—

- Is engaged to report on compiled financial statements.
- Submits financial statements to a client that are or reasonably might be expected to be used by a third party.
- Submits financial statements to a client that are not expected to be used by a third party.

Compilation Performance Requirements

.07 The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates that will enable him or her to compile financial statements that are appropriate in form for an entity operating in that industry.¹¹ This standard does not prevent an accountant from accepting a compilation engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, or individuals knowledgeable about the industry.

10. When a fraud or illegal act involves senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or the board of directors.

11. For purposes of this Statement, the term *industry* includes governmental and not-for-profit activities.

.08 To compile financial statements, the accountant should possess a general understanding of the nature of the entity's business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements. The accountant ordinarily obtains knowledge of these matters through experience with the entity or inquiry of the entity's personnel. On the basis of that understanding, the accountant should consider whether it will be necessary to perform other accounting services, such as assist in adjusting the books of account or consult on accounting matters, when he or she compiles financial statements.

.09 The accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have made inquiries or performed other procedures. The results of such inquiries or procedures, knowledge gained from prior engagements, or the financial statements on their face may cause the accountant to become aware that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory. In such circumstances, the accountant should obtain additional or revised information. If the entity refuses to provide additional or revised information, the accountant should withdraw from the engagement. (However, see AR sections 100.16–.18 for guidance when management elects to omit substantially all the disclosures required by GAAP and see AR sections 100.40–.42 for the accountant's reporting responsibilities when he or she is aware of other departures from GAAP.)

.10 Before submission, the accountant should read the financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors. In this context, the term *error* refers to mistakes in the compilation of financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosure.

Reporting on the Financial Statements

.11 When the accountant is engaged to report on compiled financial statements or submits financial statements that are reason-

ably expected to be used by a third party, the financial statements should be accompanied by a report stating that—

- a.* A compilation has been performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.
- b.* A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners).
- c.* The financial statements have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on them.

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report.

.12 The date of completion of the compilation should be used as the date of the accountant's report.

.13 Each page of the financial statements compiled by the accountant should include a reference, such as "See Accountant's Compilation Report."

.14 The following form of standard report is appropriate for a compilation:

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

.15 An accountant may be asked to issue a compilation report on one financial statement, such as a balance sheet, and not on other related financial statements, such as the statements of income, retained earnings, and cash flows. This Statement does

not preclude the accountant from doing so. Also, an accountant may be asked to compile financial statements included in a prescribed form that calls for departure from GAAP. SSARS 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*, vol. 2, AR sec. 300), provides additional guidance, including an alternative form of standard report, applicable to such compilation engagements.

Reporting on Financial Statements That Omit Substantially All Disclosures

.16 An entity may request an accountant to compile financial statements that omit substantially all the disclosures required by GAAP, including disclosures that might appear in the body of the financial statements.¹² (As previously noted, reference to GAAP in this Statement includes, where applicable, OCBOA.) The accountant may compile such financial statements provided the omission of substantially all disclosures is clearly indicated in the report and is not, to his or her knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. When the entity wishes to include disclosures about only a few matters in the form of notes to such financial statements, such disclosures should be labeled “Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included.”

.17 Notwithstanding the above, if financial statements compiled in conformity with a comprehensive basis of accounting other than GAAP do not include disclosure of the basis of accounting used, the basis should be disclosed in the accountant’s report.

.18 When financial statements that the accountant has compiled omit substantially all disclosures¹³, the following form of standard report is appropriate.

12. See AR sections 100.40-.42 for the accountant’s responsibilities when he or she is aware of other departures from GAAP. However, see SSARS 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*, vol. 2, AR sec. 300), for guidance when such financial statements are included in a prescribed form and the prescribed form or related instructions do not request the disclosures required by GAAP.

13. If the statement of cash flows is omitted, the first and third paragraphs of the report should be modified accordingly.

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all the disclosures (and the statement of cash flows) required by generally accepted accounting principles. If the omitted disclosures and statements were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

Reporting When the Accountant Is Not Independent

.19 An accountant is not precluded from issuing a report with respect to a compilation of financial statements for an entity with respect to which the accountant is not independent.¹⁴ If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

Accountant's Communications With the Client When the Compiled Financial Statements Are Not Expected to Be Used by a Third Party

.20 When an accountant submits unaudited financial statements to his or her client that are not expected to be used by a third party, he or she should either—

14. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA *Code of Professional Conduct*.

- Issue a compilation report in accordance with the reporting requirements discussed in AR section 100.11–.19.
- Document an understanding with the entity through the use of an engagement letter, preferably signed by management, regarding the services to be performed and the limitations on the use of those financial statements. (Appendix D contains “Compilation of Financial Statements Not Intended for Third-Party Use—Illustrative Engagement Letter.”)

.21 The documentation of the understanding should include the following descriptions or statements:

- The nature and limitations of the services to be performed.
- A compilation is limited to presenting in the form of financial statements information that is the representation of management.
- The financial statements will not be audited or reviewed.
- No opinion or any other form of assurance on the financial statements will be provided.
- Management has knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.
- Acknowledgment of management’s representation and agreement that the financial statements are not to be used by third parties.
- The engagement cannot be relied upon to disclose errors, fraud, or illegal acts.

The documentation of the understanding should also address the following additional matters if applicable:

- Material departures from GAAP or OCBOA may exist and the effects of those departures, if any, on the financial statements may not be disclosed.
 - Substantially all disclosures (and statement of cash flows, if applicable) required by GAAP or OCBOA may be omitted.
 - Lack of independence.
 - Refer to supplementary information.
-

Such an understanding reduces the risk that the accountant or the client may misinterpret the needs or expectations of the other party. If the accountant believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.

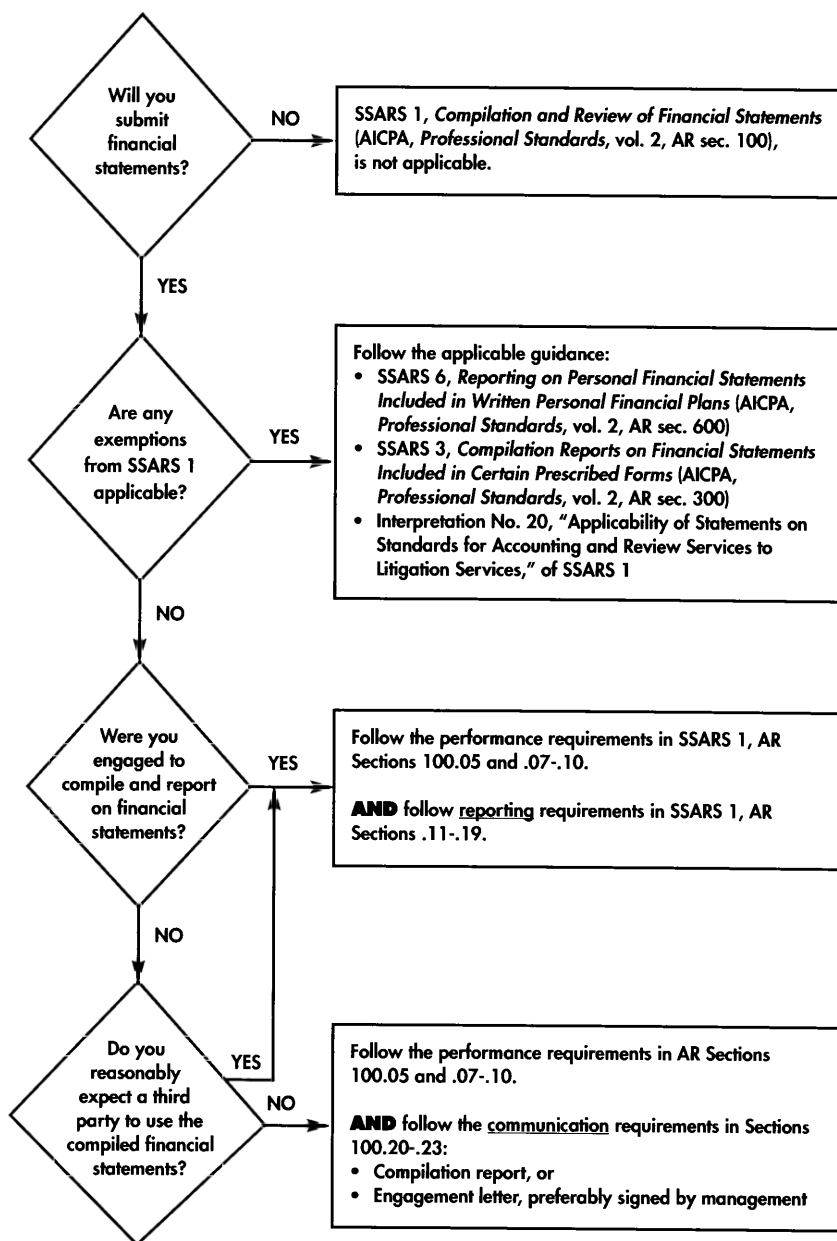
.22 The accountant should include a reference on each page of the financial statements restricting their use such as "Restricted for Management's Use Only," or "Solely for the information and use by the management of [*name of entity*]" and not intended to be and should not be used by any other party."

.23 If the accountant becomes aware that the financial statements have been distributed to third parties, the accountant should discuss the situation with the client and request that the client have the statements returned. If the client does not comply with this request within a reasonable period of time, the accountant should notify known third parties that the financial statements are not intended for third-party use, preferably in consultation with his or her attorney.

2. This Statement will be in effect for financial statements submitted after December 31, 2000.

APPENDIX A

Compilation of Financial Statements



APPENDIX D

Compilation of Financial Statements Not Intended for Third Party Use— Illustrative Engagement Letter

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will compile, from information you provide, the [*monthly, quarterly, or other frequency*] financial statements of XYZ Company for the year 20XX. A compilation is limited to presenting in the form of financial statements information that is the representation of management. We will not audit or review the financial statements and, accordingly, will not express an opinion or any other form of assurance on them. The financial statements will not be accompanied by a report.

Based upon our discussions with you, these statements are for management's use only and are not intended for third-party use.

Material departures from generally accepted accounting principles (GAAP) or other comprehensive basis of accounting (OCBOA) may exist and the effects of those departures, if any, on the financial statements may not be disclosed. In addition substantially all disclosures required by GAAP or OCBOA may be omitted. (The accountant may wish to identify known departures.) Notwithstanding these limitations, you represent that you have knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements that allows you to place the financial information in the proper context. Further, you represent and agree that the use of the financial statements will be limited to members of management with similar knowledge.

The financial statements are intended solely for the information and use of [*include list of specified members of management*] and are not intended to be and should not be used by any other party—[*optional*].

2. We will also [*discussion of other services—optional*].

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate

level of management of any material errors that come to our attention and any fraud or illegal acts that come to our attention, unless clearly inconsequential.

We are not independent with respect to [*name of entity—if applicable*].

The other data accompanying the financial statements are presented only for supplementary analysis purposes and will be compiled from information that is the representation of management, without audit or review, and we do not express an opinion or any other form of assurance on such data—[*if applicable*].

In view of the limitations described above, you agree not to take or assist in any action seeking to hold us liable for damages due to any deficiency in the financial statements we prepare and you agree to hold us harmless from any liability and related legal costs arising from any third-party use of the financial statements in contravention of the terms of this agreement. [*optional*]

Our fees for these services [*fill in*].

Should you require financial statements for third-party use, we would be pleased to discuss with you the requested level of service. Such engagement would be considered separate and not deemed to be part of the services described in this engagement letter.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.*

Sincerely yours,

[*Signature of accountant*]

Accepted and agreed to:

XYZ Company

Title

Date

* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning, "If the foregoing..." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement..."

This Statement, titled Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements, was adopted by the assenting votes of the seven members of the Accounting and Review Services Committee, of whom one, Mr. Jones, assented with qualification.

Mr. Jones approves the issuance of this Statement, but qualifies his assent for paragraph .20, which requires the accountant to document an understanding with the entity through the use on an engagement letter, preferably signed by management, for compilations not expected to be used by a third party when a compilation report will not be issued. He believes the Statement should require the engagement letter to be signed by both the accountant and management. The engagement letter documents the accountant's understanding with the entity, and management's representation and agreement that the financial statements are not to be used by third parties. The engagement letter also documents that management has knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements. Mr. Jones believes that an engagement letter signed by both the accountant and management reduces the possibility of a misunderstanding.

Accounting and Review Services Committee (1999–2000)

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